EUROPEAN UNION

DELEGATION OF THE EUROPEAN COMMISSION

File No. IB 96-261

1. The Delegation of the European Commission presents its compliments to the Department of State and has the honour to refer to the Notice of Proposed Rule-making FCC 96-484 adopted by the Federal Communications Commission on December, 19, 1996 in the matter of International Settlement Rates.

2. The European Community and its Member States welcome the decision taken by the US to support the successful conclusion of WTO/GATS Negotiations on Basic Telecommunications on February 15, 1997 in Geneva, which opens a new era for the development of the telecommunications service sector. We strongly believe that compared to any other means, the successful outcome of this historic agreement, by securing more open and competitive markets on a world-wide basis, will best serve the achievement of settlement rates closer to the actual costs. We also conclude that this agreement in the WTO demonstrates the overall consensus amongst Member countries on their firm commitment to achieve within the multilateral trade system the liberalisation in the Telecommunications sector on a global basis. The European Community and its Member States believe that it is crucial that this agreement not be impaired by FCC rules that may conflict with WTO/GATS principles.

3. The European Community and its Member States consider that the coming months are key to ensuring the effective implementation of the WTO/GATS agreement on Basic Telecommunications, and reaffirm their commitment to enforce the list of commitments scheduled by the European Community and its Member States on February 15, 1997. We are confident that the US Government is currently pursuing a similar objective; nonetheless we wish to express our concerns about the consequences of the FCC proposed policy outlined in NPRM 96-484 for liberalisation world-wide and its subsequent implications with respect to MFN and market access, given the US' obligations resulting from its list of specific commitments.

4. The European Community and its Member States re-iterate the comments made by the Delegation of the European Commission to the Department of State on February 5, of this year, that the European Community and its Member States reserve all their rights to challenge under the WTO the rules to be proposed by the FCC where these are not compatible with GATS obligations.

NPRM, i.e for the US to unilaterally lower the rates its operators will pay to have their traffic terminated in foreign countries. In this context, we also note that the average level of international accounting rates has already been decreased by one third during the last five years.

6. The European Community and its Member States also note that a great many commentators seem to suggest that it is the size of the US out-payments deficit (approximately US$ 5 Billion in 1995) that has given rise to the suggestion that settlement rates are too high. [1] The European Community and its Member States note that for any country, the balance or otherwise of incoming and outgoing traffic is determined by factors such as GDP and level of telephone usage and is a quite separate issue from the fact that settlement rates world-wide are generally far too high. If traffic were in balance and settlement rates were at their current levels, it would be equivalent to a situation where 'sender keeps all'. The structure of prices would be inefficient, however, and operators would be making excessive profits at the expense of international callers. We also share the view expressed in comments by many other parties that the NPRM incorrectly presumes that above cost accounting rates are the most important cause of US excessive outpayments. The FCC should recognise that other factors must also be taken into account as contributing to the net settlement outpayments, such as the use of alternative calling procedures that reverse the direction of traffic for billing purposes and other innovative services that bypass the traditional accounting rate system and distort traffic patterns.

7. The European Community and its Member States fully share the FCC's view expressed in paragraph 20 of the Notice that the most effective way to ensure settlement reform that results in reasonable international calling prices is through the development of competitive markets for IMTS. In competitive market structures, benchmark prices can invite price leadership and thus unnecessarily high prices. It therefore seems important that bench-marking or price posting of termination services should not occur in liberalised regulatory regimes which allow downward price competition.

8. The NPRM proposal does not explicitly state whether the US intends to continue with the system by which US operators each charge the same rate to terminate an incoming foreign call as the foreign operator charges to terminate a call from the US (sometimes referred to as a 50/50 split of the full accounting rate). However, the European Community and its Member States understand that it does; that is, that the US will charge 23.4 cent to terminate calls from low income countries, while charging 15.4 cents

from low income countries than from high income countries. Agreeing to charge both types of country the same, would put the US on a footing that is more easily defended and would respect the principle of cost orientation of accounting rates as laid down in the ITU Recommendation D.140. In regard to the World's poorer countries, doing away with the policy of reciprocal and equivalent settlement rates will at least partially offset the detrimental financial impact on low income countries, which is implied by the drastically lower benchmark settlement rates.

10. In this regard, we also note that while the three benchmarks proposed in the NPRM have been calculated from component tariff information gathered from 65 countries, the benchmarks are nevertheless relatively arbitrary, paying only passing attention to the differences in network costs that exist from country to country. This is a clear illustration of the FCC reciprocal and equivalent settlement rates which the European Community and its Member States are not in favour of.

11. The European Community and its Member States have serious concerns regarding the potential impact of the benchmarks on the World's poorer nations. Some countries and commentators have traditionally seen settlement in-payments as a form of foreign aid. We note that as a form of aid, settlement in-payments may not meet transparency and accountability measures, and that other aid mechanisms would appear to be superior. In this context, the World Bank's adjustment programme may be taken into account to help furthering investments in telecommunications infrastructure in developing countries. The European Community and its Member States invite the US to identify measures it is willing to support which will soften the transition toward cost- based settlement rates .

12. The European Community and its Member States also consider that regulatory reform of international services in the US will provide competitive benefits in the US. From the perspective of final consumers (both US and elsewhere), inflated settlement rates do not adequately explain the even more inflated collection charges levied on final consumers. The European Community and its Member States note that in a majority of countries, including the USA, collection rates net of the relevant settlement rate out-payment, are typically several times in excess of any reasonable estimation of the originating country's economic costs.[2] Indeed, in paragraph 3 of the NPRM the FCC notes that the average [published] international collection rate in the US is 99¢, compared with an average foreign settlement rate of 36¢, cited in paragraph 34 of the NPRM. Moreover, where international settlement rates have on average declined quite markedly in recent years, collection rates in the US have not followed suit. Part of the explanation for this would appear to be a lack of effective competition between US international carriers. The

does not consider measures that will encourage reductions in US collection rates to ensure a balance between the interests of carriers and consumers.

13. While the proposed benchmarks would shift US related settlement rates considerably closer to cost, the proportionate return and parallel accounting regulations in the US prevent competition between US operators to terminate incoming international traffic. The regulations are there to prevent "whip-sawing" by foreign operators where settlement rates are well in excess of economic costs. However, it seems likely that proportionate return coupled with parallel accounting regulations are also holding back competition generally between US international carriers. Our hypothesis is that the timely abolition of these regulations will provide large benefits to US final consumers, possibly larger than will be provided by the benchmark settlement rates listed in the NPRM.[3]

14. Moreover, in the increasingly liberalised communications world toward which we are moving, the European Community and its Member States believe that proportionate return coupled with parallel accounting regulations will be only partially effective. Given their potentially negative impact on the development of competition, we invite the US to consider further the efficacy of these regulations in light of the actual cost and benefit.

15. We also note that the procedure set by the FCC in its Flexibility Order FCC 96-459 docket N° CC 90-337 to deviate from the International Settlements Policy and the possibility for US carriers to get approval by the FCC to enter into alternative arrangements to the traditional accounting rates relies on the satisfaction of the ECO-test which the European Community and its Member States do not consider consistent with the MFN principle. This will have to be adjusted as a result of the WTO/GATS agreement on Basic Telecommunications Services as from the date of implementation, i.e. 1 January 1998.

16. In Paragraphs 76 to 82, the FCC proposes notably to condition any authorisations for carriers seeking to provide international facilities-based service from the United States to an affiliated foreign market to provide switched services or private line service on the existence of a settlement rate within the benchmark range. In the light of the above comments, the European Community and its Member States take the view that international settlement rates should be subject to commercial negotiations between carriers and without undue interference by national authorities. The FCC proposal may well result in a disguised market access barrier detrimental to competition by imposing constraints more burdensome than necessary on carriers seeking access to the US market. Unless proven otherwise, we also understand that in the case where different benchmarks

been distorted. In this regard, the FCC has not provided a clear and transparent definition of such a distorsion, and respective procedures which it would use to carry out such assessment. The European Community and its Member States wish to underline that the application of the GATS principles and the Dispute Settlement Mechanism established under the auspices of the WTO provide appropriate safeguards and remedies against distortions to trade while securing the effective implementation of commitments by WTO Members. Furthermore, we wish to highlight that as from the date of entry into force of the WTO/GATS Agreement on Basic Telecommunications services, any licensing conditions, -including obviously those directed towards safeguards and remedies against distortions of competition-, will have to comply with the requirements of Article VI of the GATS, namely, be objective, transparent and not more burdensome than necessary to ensure the quality of the service.

18. Hence, taking into account the positive outcome of the GATS/WTO Negotiations on Basic Telecommunications, and subsequently the overall consensus over the liberalisation of the Telecommunications sector, the European Community and its Member States request the FCC to reconsider its proposal where necessary to ensure a full compatibility of the NPRM with GATS principles. In regard to the Flexibility Order, the ECO Test and the DISCO II test, the European Community and its Member States similarly request the FCC to also amend the rules where necessary so that they do not conflict with GATS principles.

19. The Delegation of the European Commission would be grateful for the views of the Department of State, and requests that this Note *Verbale* be transmitted to the Federal Communications Commission so that it can be part of the proceedings in this matter and put in the public record.

20. The Delegation of the European Commission avails itself of the opportunity to renew to the Department of State the assurance of its highest consideration.

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